MOTION FILED
AUG 5 1996

No. 95-1402

(7)

In The

Supreme Court of the United States

October Term, 1995

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

ESTATE OF OTIS C. HUBERT, DECEASED,
C & S SOVERAN TRUST COMPANY (GEORGIA) N.A.,
A NATIONAL BANKING ASSOCIATION, CO-EXECUTOR,

Respondent.

On Writ Of Certiorari To The United States Court of Appeals For The Eleventh Circuit

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL URGING AFFIRMATION AND BRIEF OF THE AMICUS CURIAE IN SUPPORT OF RESPONDENT

EDWARD F. KOREN, Esquire
400 North Ashley Drive
Suite 2300
Post Office Box 1288
Tampa, Florida 33601-1288
(813) 227-6655
Counsel of Record

ALVIN J. GOLDEN, Esquire
823 Congress Avenue, Suite 910
Austin, Texas 78701
(512) 472-6695

HOWARD M. MCCUE, III, Esquire
190 S. LaSalle Street, Suite 3639
Chicago, Illinois 60603
(312) 701-7102

Counsel for Amicus Curiae
The American College of Trust
and Estate Counsel

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

14 pp
$10

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL URGING AFFIRMATION

Pursuant to Rule 37.4 of the Rules of the Court, the American College of Trust and Estate Counsel moves to appear as Amicus Curiae and for leave to file the attached amicus curiae brief urging that the opinion of the Court of Appeals for the Eleventh Circuit be AFFIRMED. Pursuant to Rule 37.3, the Respondent has given the College a written consent to file this amicus curiae brief, but the Petitioner has not, thereby requiring that this motion be filed.

The College is a professional association of lawyers with a current membership of over 2,700 Fellows from throughout the United States who have been elected to membership by their peers on the basis of their professional reputation and their demonstrated exceptional skill and ability in probate, trust, estate planning and employee benefits law, and who have made substantial contributions to these fields through lecturing, writing, teaching, and bar activities. As a professional organization dedicated to the service and advancement of the law, the College wishes to make available to the Court its expertise in such a way as to provide whatever assistance it may in resolving the complex issues that have vexed the lower courts at all levels, and have produced significant uncertainty among practitioners and government personnel in the administration of estates throughout the country.

The College does not undertake the filing of amicus curiae briefs lightly. It has a stringent policy requiring that such briefs be filed on behalf of the College only on

issues of special significance to the legal profession and to the public, and then only with the consent of the Board of Regents of the College. Even then, such briefs may only be filed in support of a position of the College. Because of its recognized preeminence in the estate planning, probate, trust, and employee benefits bars, the College does not take a position without careful consideration, nor does it adopt a position that it believes is not in the public interest.

The issue to be decided in this case has a far-reaching impact both on planning for estate administration and on the administration itself. The members of the College each have many years of practical experience in planning and administering estates. This expertise provides a perspective not available from either the Commissioner or the individual taxpayer.

The College's brief supports the contention of Respondent that when administration expenses are properly charged to income under the applicable state law or the governing instrument, and are actually paid out of the income from the estate, the marital and charitable deductions should not be reduced. To hold otherwise is to thwart the intent of the laws of the several states that allow the estate to allocate payment of expenses between different beneficial interests. The College does, however, agree with Petitioner's statement that where administration expenses are properly charged to the corpus of the estate under applicable state law, the marital and charitable deductions must be reduced, even when estate income is used to pay the expenses.

The College's position differs to an extent from that of Respondent in that the College proposes a two-prong

test for determining whether administration expenses will reduce the marital and charitable deductions in a given estate. This test, not advocated by either Petitioner or Respondent, seeks to balance the interests of the estate and state law with the interests of the Commissioner.

The College's brief, while supporting the result urged by Respondent, nevertheless seeks to take a broader view of the problems and to deal with arguments that may not be sufficiently raised or dealt with by the parties. Additionally, the College will bring to the attention of the Court certain consequences, not readily apparent, which would naturally flow from a decision for Petitioner.

WHEREFORE, having shown that the College brings a different perspective to the proceedings, and that the expertise of the College in estate planning, probate, trust, and employee benefits law will allow it to bring to the attention of the Court relevant matters not raised by the

parties, the College prays that its motion for leave to file its amicus curiae brief be GRANTED.

Respectfully submitted,

EDWARD F. KOREN, Esquire
400 North Ashley Drive
Suite 2300
Post Office Box 1288
Tampa, Florida 33601-1288
(813) 227-6655
Counsel of Record

ALVIN J. GOLDEN, Esquire
823 Congress Avenue, Suite 910
Austin, Texas 78701
(512) 472-6695

HOWARD M. MCCUE, III, Esquire
190 S. LaSalle Street, Suite 3639
Chicago, Illinois 60603
(312) 701-7102

Counsel for Amicus Curiae
The American College of Trust
and Estate Counsel

No. 95-1402

In The

Supreme Court of the United States

October Term, 1995

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

ESTATE OF OTIS C. HUBERT, DECEASED,
C & S SOVERAN TRUST COMPANY (GEORGIA) N.A.,
A NATIONAL BANKING ASSOCIATION, CO-EXECUTOR,

Respondent.

On Writ Of Certiorari To The United States Court of Appeals For The Eleventh Circuit

BRIEF OF THE AMICUS CURIAE IN SUPPORT OF RESPONDENT

QUESTION PRESENTED

Whether in calculating the taxable estate for the purpose of the federal estate tax, the marital and charitable deductions allowed by Section 2055 and 2056 of the Internal Revenue Code, 26 U.S.C. § 2055 and § 2056, are reduced by the expenses of administration of the estate that are properly chargeable to income under the applicable state law or the governing instrument.

TABLE OF CONTENTS

Page

INTEREST OF THE AMICUS CURIAE 1

SUMMARY OF THE ARGUMENT 2

ARGUMENT 3

NEITHER THE FEDERAL ESTATE TAX STATUTE NOR THE COMMISSIONER'S OWN REGULATION REQUIRES THE MARITAL DEDUCTION TO BE REDUCED IF ADMINISTRATION EXPENSES ARE PROPERLY CHARGED TO ESTATE INCOME 3

PERMITTING ADMINISTRATIVE EXPENSES TO BE CHARGED TO ESTATE INCOME WITHOUT AFFECTING THE MARITAL OR CHARITABLE DEDUCTIONS IS CONSISTENT WITH THE TAX TREATMENT ACCORDED A DECEDENT'S ASSETS THAT PASS UNDER A REVOCABLE TRUST 10

ADMINISTRATION EXPENSES CANNOT "ACCRUE" AT DEATH, AND THE COMMISSIONER'S POSITION TO THE CONTRARY IMPROPERLY CREATES DIFFERENT CATEGORIES OF ADMINISTRATIVE EXPENSES 12

CONCLUSION 16

TABLE OF AUTHORITIES

Page

CASES

Estate of Hubert v. Commissioner, 63 F.3d 1083 (11th Cir. 1995) 7, 15

Estate of Richardson v. Commissioner, 89 T.C. 1193 (1987) 13

Estate of Street v. Commissioner, 974 F.2d 723 (6th Cir. 1992) 13, 14, 15

STATUTES AND REGULATIONS

26 U.S.C. § 642(g) 15, 16

26 U.S.C. § 2055 3

26 U.S.C. § 2055(d) 3

26 U.S.C. § 2056 ..... 3, 11

26 U.S.C. § 2056(a) 3

26 U.S.C. § 2056(b)(4)(a) 8

26 U.S.C. § 2523(e) 8, 11

26 C.F.R. § 20.2056(b)-(4)(a) 3, 4, 6, 8, 10, 16

26 C.F.R. § 20.2056(b)-(5)(f)(3) 3, 8, 11

26 C.F.R. § 25.2523(e)-1(f)(3) 3, 8, 11

14 Vir. Stat. Ann. § 3304 (1995) 13

Off. Code Ga. Ann. § 53-12-219 (1996) 13

Tenn. Code Ann. § 35-6-113 (1996) 13

Unif. Principal & Income Act (1962 Revised) § 5, 7B U.L.A. 160 (1996) 13

TABLE OF AUTHORITIES – Continued

Page

OTHER

Rev. Rul. 69-56, 1969-1 C.B. 224 ..... 8, 11

Rev. Rul. 93-48, 1993-2 C.B. 270 ..... 13, 14

Laura O. Lazarus, *Limitations on the Qualified Terminable Interest Property Marital Deduction: Estate of Ellingson v. Commissioner*, 46 Tax Law. 959 (Summer 1993) 5

Ronald D. Aucutt, *Further Observations on Transfer Tax Restructuring: A Practitioner's Perspective*, 42 Tax Law. 343 (Winter 1989) 5

INTEREST OF THE AMICUS CURIAE

The College is a professional association of lawyers with a current membership of over 2,700 Fellows from throughout the United States who have been elected to membership by their peers on the basis of their professional reputation and their demonstrated exceptional skill and ability in probate, trust, estate planning and employee benefits law, and who have made substantial contributions to these fields through lecturing, writing, teaching, and bar activities. The College has no "client" in this matter, although many of its Fellows represent clients who will be impacted by the Court's decision, either now or in the future. But as a professional organization dedicated to the service and advancement of the law, the College wishes to make available to the Court its expertise in such a way as to provide whatever assistance it may in resolving the complex issues that have vexed the lower courts at all levels, and have produced significant uncertainty among practitioners and government personnel in the administration of estates throughout the country.

The issue to be decided in this case has a far-reaching impact on both planning for estate administration and on the administration itself. The members of the College each have many years of practical experience in planning and administering estates. This expertise provides a perspective not available from either the Commissioner or the individual taxpayer.

SUMMARY OF THE ARGUMENT

Administration expenses charged against income should not reduce a marital or charitable deduction, unless they are of such an amount that they constitute a material limitation on the deductible interest. While there always should be an offset for such expenses if they are charged to corpus, the Commissioner's own regulation requires an examination of whether payment of the expenses from income earned by the estate during its administration materially limits the entire income right of the spouse or charity. If the effect of the payment is considered material, that effect should be valued, and the amount so determined deducted from the value of the marital or charitable gift. If the limitation on the right to receive income is not material, the deductible amount of the gift should not be affected.

Such treatment does not create an abuse of the tax code, and neither the government nor the marital or charitable beneficiaries will be harmed. Furthermore, upholding the lower court decision will provide consistent treatment between transfers by will and those occurring through inter vivos trusts. The growing use of revocable trusts in estate planning makes this latter consideration especially pertinent.

Because there is no statutory authority for the position that some administration expenses are an encumbrance on the gross estate as of the date of death, while others accrue over the course of administering the estate, there is no basis in the tax law for creating different categories of administration expenses. This Court should not allow different treatment of some administration expenses based on distinctions that do not exist, and

therefore, the decision of the Court of Appeals should be upheld.

ARGUMENT

NEITHER THE FEDERAL ESTATE TAX STATUTE NOR THE COMMISSIONER'S OWN REGULATION REQUIRES THE MARITAL DEDUCTION TO BE REDUCED IF ADMINISTRATION EXPENSES ARE PROPERLY CHARGED TO ESTATE INCOME.

The principal issue to be determined in this case involves the construction of the applicable statutes and regulations. 26 U.S.C. § 2055 and § 2056 and 26 C.F.R. § 20.2056(b)-(4)(a), § 20.2056(b)-(5)(f)(3) and § 25.2523(e)-1(f)(3). Section 2056(a) provides a marital deduction in computing federal estate tax for the "amount equal to the value of any interest in property which passes . . . from the decedent to his surviving spouse." Similarly, section 2055(d) provides a charitable deduction in computing the estate tax equal to the "value of the . . . property" that is transferred to a qualifying charitable organization. The regulation most applicable to determining the amount of the deduction provides, in pertinent part, as follows:

> . . . The marital deduction may be taken only with respect to the net value of any deductible interest which passed from the decedent to his surviving spouse, the same principles being applicable as if the amount of a gift to the spouse were being determined. In determining the value of the interest in property passing to the spouse account must be taken of the effect of any material limitations upon her right to the

> income from the property. An example of a case in which this rule may be applied is a bequest of property in trust for the benefit of the decedent's spouse but the income from the property from the date of the decedent's death until distribution of the property to the trustee is to be used to pay expenses incurred in the administration of the estate.

26 C.F.R. § 20.2056(b)-(4)(a).

The Commissioner's interpretation of this regulation focuses on the "net economic interest" that is passed to the surviving spouse or charitable beneficiary. Unquestionably, when expenses are paid from the *corpus* of the estate (i.e., from the deductible gift), the net economic interest that is passed to the beneficiary is less, and the deduction should be reduced. If, however, there is sufficient estate income to pay those expenses and the *corpus* is kept intact, then the surviving spouse or charity will eventually receive not only the full bequest, but also will have a larger investment base that can generate more gross income, using the assumptions stated in the Appendix.[1]

---

[1] To illustrate this principle, consider the following example. Assume one is offered the opportunity to purchase a 20-year bond with a $100,000 face, paying 10% annually. Further assume there is a $10,000 commission, but there are two possible ways it is charged: either pay the face value of $100,000 and receive no income the first year (the $10,000 of interest being used to pay the commission), or pay $100,000 and receive a bond with a face value of only $90,000 (the $10,000 commission reducing the principal of the bond), which would then pay interest the first year (and annually thereafter), but of only $9,000 per year. By reducing income in the first year to take advantage of the higher face value of the bond, and assuming all income is spent as it is distributed, the buyer's estate would be $10,000 greater at the end of 20 years ($100,000 face compared to $90,000), and the buyer also would have received about $10,000 more income over the term of the bond ($10,000 x 19 years as opposed to $9,000 x 20 years, ignoring income earned on the $10,000 used to pay the commission at the end of the first year).

Planners and the government alike agree that the marital deduction is "an important estate planning tool for married individuals by enabling them to defer federal wealth transfer taxes until the surviving spouse's death." Laura O. Lazarus, *Limitations on the Qualified Terminable Interest Property Marital Deduction: Estate of Ellingson v. Commissioner*, 46 Tax Law. 959 (Summer 1993). The purpose of deferring these taxes is to "protect the capital needed for the support and security of both spouses during their lives." Ronald D. Aucutt, *Further Observations on Transfer Tax Restructuring: A Practitioner's Perspective*, 42 Tax Law. 343 (Winter 1989). Reducing the marital deduction as urged by the Commissioner would, in turn, reduce the value of the estate passing to the surviving spouse, thus thwarting the purpose of the unlimited marital deduction that was adopted in 1981. The taxpayer is not *avoiding* estate taxes on the increased amount that passes to the surviving spouse; this amount (and perhaps more, based on a reasonable growth rate) will be collected from the spouse's estate at death. Thus, it becomes a *timing* issue as to when (not whether) these taxes are collected, and Congress has spoken to that issue, opting to permit deferral until the death of both spouses.

Under the stipulated facts of this case, the decedent died on June 2, 1986. A *bona fide* will contest followed,

which was settled on October 10, 1990. Substantial administration expenses were incurred in connection with that contest, numerous tax controversies and other aspects of the administration of the estate. During the relevant administration period, the estate (with assets of more than $30,000,000) generated income of more than $4,500,000 and incurred expenses of more than $2,000,000. Of this amount, approximately $507,000 was allocated to and paid from the principal of the estate, and the balance (presumably most of which were incurred after the estate tax return was filed) was allocated to and paid from post-death income of the estate. The expenses allocated to principal were deducted on the estate tax return, while those allocated to income were deducted on the estate's income tax returns.

The question presented is whether marital and charitable deductions allowed to the estate by sections 2056 and 2055 of the Internal Revenue Code are reduced by the expenses of administration of the estate allocated to and paid from the income of the estate. The Commissioner relies upon the language of regulation section 20.2056(b)-4(a) quoted above, acknowledging that this regulation section should be controlling. Accordingly, the most important issue before this Court is the correct interpretation of that regulation.

The Commissioner suggests that this regulation mandates subtractions from the value of the bequests otherwise qualifying for the marital or charitable deduction. She further contends that these subtractions are required in all cases in which administration expenses are allocated to income, without regard to the amount of the

estate income and the amount of the expenses paid therefrom. These contentions disregard the plain language of the regulation, and they are incorrect.

Instead, as noted by both the Tax Court and the Eleventh Circuit, the regulation addresses valuation. A correct analysis of its provisions involves a two-step process. First, there must be a determination of whether the payment of expenses from income constitutes a *material limitation* on the right of the surviving spouse or charity to receive income from the marital or charitable gift property. If such payments from income are not (in the Commissioner's regulatory words) a *material* limitation on the spouse's (or charity's) rights, then the regulation provides that the marital or charitable deductions are not affected, and the analysis is complete. In this regard, materiality must be measured under the facts and circumstances of the particular case. But if, under such circumstances, it is determined that those payments do constitute a material limitation, then (again in the words of the regulation) "account must be taken of the effect" of that limitation on the value of the property interest passing to the spouse or charity. In other words, if a limitation is material under the particular circumstances, then it must be valued, and the value so determined must be subtracted from the net value of the property interest to determine the deductible amount for purposes of the marital or charitable deduction.

In this case, the lower courts determined that there was no need to address the second step of this test. After carefully analyzing the facts in *Hubert*, the Tax Court determined that the payment of administration expenses out of income was not a material limitation on the right of

the surviving spouse or charity to receive income. In this connection, the Tax Court noted that, both under the statute and the Commissioner's interpretive regulations, the effect of an encumbrance on the spouse's interest should be determined with reference to the related gift tax marital deduction provisions. 26 U.S.C. § 2056(b)(4)(a); 26 C.F.R. § 20.2056(b)-(4)(a). Section 2523(e) of the Code and the regulations promulgated thereunder make it clear that a spouse is considered to receive all of the income from a trust, even if certain expenses and other charges (including fees and commissions paid trustees) are paid from trust income. 26 U.S.C. § 2523(e) and 26 C.F.R. § 25.2523(e)-1(f)(3). Similarly, in a Revenue Ruling that interpreted section 20.2056(b)-5(f)(3) of the estate tax regulations, the Commissioner has acknowledged that a discretionary power "to charge to income or principal, executor's or trustee's commissions, legal and accounting fees, custodian fees, and similar administration expenses" will cause neither the disallowance nor the reduction of the estate tax marital deduction. Rev. Rul. 69-56, 1969-1 C.B. 224.

The Commissioner's brief asks this Court to disregard the word "material" in the quoted regulatory language, suggesting that *any* allocation of administration expenses to the income of a marital or charitable bequest should result in a reduction in the value of that bequest for purposes of computing the applicable marital or charitable deduction. This approach ignores the plain language of the regulation, which states that any "material limitation" on the right to receive income be *given effect* in the determination of the value of the interest passing to the spouse for charity. The mention of administration

expenses in this section is identified as an *example* that "may be applied" where *all* of the income "from the date of the decedent's death until distribution of the property to the trustee is to be used to pay expenses incurred in the administration of the estate"; that language can not be construed as a mandate that the discretionary use of *some* income to pay such expenses is always a material limitation.

The Tax Court and the Eleventh Circuit both properly determined that there must be an initial analysis to determine whether the allocation of expenses to income results in a material limitation upon the spouse's or charity's right to income over the term of the gift. When the amounts charged to the income of a marital or charitable bequest – viewed in the perspective of the aggregate amount of income generated by that bequest – do not constitute a "material" limitation on the right of the surviving spouse or charity to receive income from the bequeathed property, no reduction of the marital or charitable deduction is called for by the regulation, and none is appropriate. Once the Court concludes that such payments are not material, that conclusion should be the end of the inquiry.

If, on the other hand, the payment of administration expenses from the income of a marital or charitable bequest *does* constitute a material limitation on the right of the surviving spouse (or of the charity) to receive income, then the issue becomes a question of valuation. In such circumstances, the value of the material limitation must be determined and the value so determined subtracted from the value of the qualifying property for

purposes of computing the applicable marital or charitable deduction. The Commissioner focuses too narrowly on a dollar-for-dollar adjustment to the marital deduction (suggesting that *any* adjustment is "material"), rather than analyzing the true economic impact on the marital gift by paying expenses from its income. The real economic value of a marital bequest in trust is not its immediate principal amount, but the income stream available for the surviving spouse's lifetime.[2] By reducing the marital deduction in an amount exactly equal to the portion of the income spent on expenses, the Commissioner is going beyond a concept of "giving effect" to material limitations on the income stream of the spouse or charity.

PERMITTING ADMINISTRATIVE EXPENSES TO BE CHARGED TO ESTATE INCOME WITHOUT AFFECTING THE MARITAL OR CHARITABLE DEDUCTIONS IS CONSISTENT WITH THE TAX TREATMENT ACCORDED A DECEDENT'S ASSETS THAT PASS UNDER A REVOCABLE TRUST.

A further flaw in the Commissioner's position is that it creates inconsistent tax treatment between estates governed by wills and those governed by revocable trusts. The Commissioner has attempted to focus the issue solely on her narrow reading of regulation section 20.2056(b)-(4)(a), but ignores that regulation's reference to other sections. In fact, the regulation states that the principles under the gift tax provisions will be applicable

---

[2] See Appendix. The economic analysis in the Appendix is consistent with the Commissioner's other regulatory provisions that address substantially the same issue.

in making this determination of value. Under 26 U.S.C. § 2523(e), a deduction for a gift to a spouse in trust is permitted only if the spouse is entitled to all of the trust income. The regulations further provide that, so long as the spouse is not deprived of substantial beneficial enjoyment, he or she is considered to receive all of the trust income even when "trustees' commissions, and other charges" are paid out of the income. 26 C.F.R. § 25.2523(e)-1(f)(3). The estate tax regulations at section 20.2056(b)-(5)(f)(3) use the same language in the case of a gift by a decedent to a spouse made in trust so that, again, trustees' commissions do not affect the interest to be passed unless their payment constitutes a material limitation on the income interest. 26 C.F.R. § 20.2056(b)-(5)(f)(3). Indeed, the Commissioner has interpreted these sections in a published ruling and concluded that charging such administration expenses will not "result in the disallowance or diminution of the marital deduction under sections 2056 and 2523 of the Code." Rev. Rul. 69-56, 1969-1 C.B. 224.

To argue for a different result for probate estates creates a significant conflict between the tax treatment accorded the settlement of decedents' estates in which wills are involved and those in which revocable trusts are the principal testamentary device. The use of revocable trusts has increased significantly as a tool in estate planning over the past generation. To create such disparate treatment between probate and nonprobate gifts is illogical, lacks any policy basis, and creates an inconsistency in the application of the regulations.

It is, moreover, difficult to justify a distinction between trustee's commissions and other administration

expenses. Both are incurred while administering the transfer of an interest. The form of the transfer – by will or by trust – should not be the determining factor in deciding whether the marital deduction is to be reduced. Thus, to avoid a dichotomy between probate and trusts, administration expenses for a probate estate needs to be given the same effect as trustees' commissions and normally should not lead to a reduction in the marital deduction, unless their payment constitutes a material limitation on the spouse's income rights.

ADMINISTRATION EXPENSES CANNOT "ACCRUE" AT DEATH, AND THE COMMISSIONER'S POSITION TO THE CONTRARY IMPROPERLY CREATES DIFFERENT CATEGORIES OF ADMINISTRATIVE EXPENSES.

Although the principal focus of this case should be the two-part test discussed above regarding the existence of a material limitation on the right to income, the Commissioner argues for a *per se* rule that administration expenses – whether chargeable to corpus or to income – are an encumbrance on the gross estate that must reduce the marital and charitable deductions. This ignores the very significant legal differences in the rights accorded income and principal beneficiaries by the principal and income laws of the several states that direct how income and expenses of trusts and probate estates are to be allocated. Some jurisdictions have recognized that an inflexible rule that requires administration expenses be charged to corpus may be inappropriate, and have permitted discretion in the allocation of these expenses

between the assets of the estate and the income it generates after the decedent's death. *See e.g.*, Unif. Principal & Income Act (1962 Revised) § 5, 7B U.L.A. 160 (1996); Off. Code Ga. Ann. § 53-12-219 (1996); Tenn. Code Ann. § 35-6-113 (1996); 14 Vir. Stat. Ann. § 3304 (1995). Recognizing this distinction, the Commissioner has conceded that *certain* administration expenses properly chargeable to income do *not* reduce the marital and charitable deductions. Rev. Rul. 93-48, 1993-2 C.B. 270. Adopting her *per se* rule would force taxpayers to make illogical distinctions between various types of administration expenses.

In her brief, the Commissioner failed to address the Tax Court decision that began the inquiry into this issue, *Estate of Richardson v. Commissioner*, 89 T.C. 1193 (1987). That decision considered whether interest on estate taxes that accrues during the probate period is an expense that reduces the marital deduction. The court first held that interest on estate taxes is an administration expense rather than an additional tax. *Id.* at 1205. Because applicable state law allowed administration expenses to be allocated between principal and income, and because the estate rightfully chose to allocate and pay the interest on estate taxes from income, the *Richardson* court concluded that such an expense was deductible, and did not reduce the marital deduction. *Id.* at 1206. This holding has been cited with approval by *every* circuit court that has considered the issue: the Sixth Circuit in *Estate of Street v. Commissioner*, 974 F.2d 723 (6th Cir. 1992) and the Eleventh Circuit in this case. Additionally, the Commissioner has acknowledged the correctness of the Tax Court's recognition of the distinction between charging interest expense to income or principal, and has issued a Revenue

Ruling adopting the Tax Court's holding. Rev. Rul. 93-48, 1993-2 C.B. 270.

By making the argument that interest on federal estate taxes is different from other administration expenses, the Commissioner is asking this Court to create "categories" of administration expenses, some of which will reduce the marital and charitable deductions and some of which will not. Nothing in any version of the Internal Revenue Code supports such a result.

Despite this lack of statutory authority, the Sixth Circuit, in *Estate of Street*, somehow concluded that interest on estate taxes should be treated differently than other administration expenses. Perhaps it reached this erroneous result by focusing on prior situations in which administrative expenses were required to be charged under applicable state law to the corpus of the estate. Although the governing law in the Street estate permitted a proper charge of such expenses to income, the Sixth Circuit concluded that the estate tax result should be no different than if the expenses were required to be charged to corpus, because it considered that administration expenses "accrue at the time of death." *Estate of Street*, 974 F.2d at 727. Tellingly, the court cited no authority for this statement. Indeed, there is no authority for a position other than that administration expenses accrue as services are rendered to the estate, or an expense on its behalf is incurred.

The American College of Trust and Estate Counsel can find no legal or practical support for a position that administration expenses accrue at death, rather than during the administration of the estate. Unlike debts of a

decedent, the obligation to pay administration expenses arises when the service is rendered, or when the expense is incurred.[3] In cases such as this, where litigation is ongoing more than ten years after the death of the decedent, the costs of administration clearly have arisen over a period of time (much of which, as in this case, may be beyond the applicable estate tax statute of limitations). To argue that the Hubert estate had the obligation on June 2, 1986, to pay attorney's fees that would not be incurred until 1996 defies common sense and the probate and trust laws of the several states. Those laws, as modified by the applicable instrument, properly determine whether such expenses are to be charged against the principal of the residuary estate, or the income of the entire estate.

The Commissioner also argues that upholding the lower court ruling would allow the taxpayer the equivalent of a double deduction that is prohibited by 26 U.S.C. § 642(g). Section 642 prohibits an estate tax deduction for administration expenses that have been deducted against the estate's income tax. *Estate of Hubert v. Commissioner*, 63 F.3d 1083, 1085 (11th Cir. 1995). To allow such a deduction would lead to the estate deducting the same expense

---

[3] The College recognizes that often administration expenses are deducted on a timely filed federal estate tax return before such expenses have actually accrued in a pure accounting sense; *e.g.*, attorney's fees and executor's commissions. The distinction drawn by the *Street* court and urged by the Commissioner as to the time of accrual of interest on taxes *vis-a-vis* other administrative expenses should not affect the ability of a taxpayer to make reasonable estimates of expenses for deduction on the federal estate tax return. The time of deductibility on the estate's income tax return is governed by the income tax rules.

twice. Yet there is no such prohibition or reduction under section 642(g) for marital or charitable deductions. *Id.* These deductions are based on the value of the gross estate at death, 26 C.F.R. § 20.2056(b)-(4)(a), not on how much administrative expense is incurred. In short, the *preservation* of the marital and charitable deductions is not barred by section 642(g).

CONCLUSION

The judgment of the Court of Appeals should be affirmed, and the two-prong test suggested in this brief adopted as a method of determining how administrative expenses, of whatever type, impact the amount of the marital or charitable deduction.

Respectfully submitted,

EDWARD F. KOREN, Esquire
400 North Ashley Drive
Suite 2300
Post Office Box 1288
Tampa, Florida 33601-1288
(813) 227-6655
Counsel of Record

ALVIN J. GOLDEN, Esquire
823 Congress Avenue, Suite 910
Austin, Texas 78701
(512) 472-6695

HOWARD M. MCCUE, III, Esquire
190 S. LaSalle Street, Suite 3639
Chicago, Illinois 60603
(312) 701-7102

Counsel for Amicus Curiae
The American College of Trust
and Estate Counsel

APPENDIX

In our experience, the survivor generally spends all or a substantial part of the distributed income, and does not reinvest it. Assuming that to be the case, there will be a difference in cash flow to the survivor depending upon whether the income was used to pay expenses.[4] Therefore, to determine the real economic effect on the marital gift of treating income as the Commissioner suggests and to arrive at a fair conclusion regarding its true value, one should calculate the aggregate cash flow for the marital gift, both with and without the income used to pay expenses, and then reduce those respective amounts to present value. The only logical time-frame in which to make such a calculation is the life expectancy of the surviving spouse, which is easily determinable. For example, assume a residuary marital trust of $2,000,000 growing at a sustained rate of 4% per year and producing after-tax income at 6% per year. If the expenses of administration total $100,000, the surviving spouse can actually receive *more* gross income over his or her life by deducting expenses against income. Given a surviving spouse with a 15-year life expectancy, the stream of income available to the spouse after deducting administrative expenses would amount to $2,215,030. The value of the aggregate income produced for the same period by a lesser principal amount (reduced by $100,000 of the expenses as suggested by the Commissioner and also by

[4] If the assumption is changed and all income is reinvested at the same rate as the corpus, there should be no significant economic difference in the results, thus demonstrating again the lack of a material limitation on the income right.

the increase of $58,000 in estate taxes caused by the partial loss of the marital deduction) is $2,141,621. If the spouse in fact lives beyond 15 years, this discrepancy will accelerate, inasmuch as the principal of the marital trust is then $270,000 higher. Both computations assume the interest is expended and not reinvested. But even if the *present value* of this income stream is determined (which creates the need for more assumptions), any decrease in the value of the spouse's right to income is not material under these facts (the difference in present values being less than 5%).[5] Moreover, at no time is the combined value of the principal and distributed income *less* in the "payment of expenses from income" scenario.

---

[5] The present value (calculated for 15 years at a 6% discount rate) of the stream of income earned when administration expenses are charged to income (column 3) is $1,343,837. The present value of the income stream when expenses are paid from and charged to the marital gift (column 6) is $1,371,928. The ratio of these present values is 97.95%.

	Administration Expenses paid from and charged against income			Administration Expenses paid from and charged against corpus of Marital Gift		
	Values during administration	Annual income earned	Cumulative Income	Values during administration	Annual income earned	Cumulative Income
Total Administration Expenses	100,000			100,000		
Income earned in first year (6% annual)	120,000			120,000		
Original Gift to Spouse	2,000,000			2,000,000		
Administration Expenses charged to principal	-0-			100,000		—
Net value of Marital Gift	2,000,000	20,000	20,000	1,842,000[6]	120,000	120,000
Values as of year 2[7]	2,080,000	120,000	140,000	1,915,680	110,520	230,520
Values as of year 3	2,163,200	124,800	264,800	1,992,307	114,941	345,461
Values as of year 4	2,249,728	129,792	394,592	2,071,999	119,538	464,999
Values as of year 5	2,339,717	134,984	529,576	2,154,879	124,320	589,319
Values as of year 6	2,433,306	140,383	669,959	2,241,074	129,293	718,612
Values as of year 7	2,530,638	145,998	815,957	2,330,717	134,464	853,076
Values as of year 8	2,631,864	151,838	967,795	2,423,946	139,843	992,919
Values as of year 9	2,737,139	157,912	1,125,707	2,520,904	145,437	1,138,356
Values as of year 10[8]	2,846,625	164,228	**1,289,935**	2,621,740	151,254	**1,289,610**
Values as of year 11	2,960,490	170,798	1,460,733	2,726,610	157,304	1,446,914
Values as of year 12	3,078,910	177,629	1,638,362	2,835,674	163,597	1,610,511
Values as of year 13	3,202,066	184,735	1,823,097	2,949,101	170,140	1,780,651
Values as of year 14	3,330,149	192,124	2,015,221	3,067,065	176,946	1,957,597
Values as of year 15	3,463,355	199,809	**2,215,030**	3,189,748	184,024	**2,141,621**

[6] Assuming the marital deduction is reduced, the loss of a deduction for administration expenses increases the estate tax by $58,000, which must be paid from the principal of the marital gift.

[7] Assuming appreciation of 4% per year for principal.

[8] This is the approximate breakeven point for income distributions. If a higher rate of return is assumed (e.g., the Applicable Federal Rate of 8.2% for June 1996), the breakeven point would occur earlier (between years 7 and 8).